UNITED STATES SENATOR • IOWA
CHUCK GRASSLEY
RANKING MEMBER • SENATE COMMITTEE ON FINANCE

http://grassley.senate.gov
press_office@grassley.senate.gov

Contact: Jill Kozeny, 202/224-1308
Jill Gerber, 202/224-6522

Opening Statement of Sen. Chuck Grassley
Hearing, "The Role of the Extraterritorial Income Exclusion Act in the International Competitiveness of U.S. Companies"
Tuesday, July 30, 2002

We are at a significant juncture. Since 1962, the United States has tried to remedy the competitive disadvantages of its worldwide tax system by enacting various regimes to level the international playing field. The U.S., however, has lost every time one of these regimes has been challenged in the international trade courts.

First there was DISC, followed by FSC, and now, most recently, the Extraterritorial Income (ETI) regime – all have been ruled to be in violation of our international trade agreements. Today, we await word on how much the EU can sanction the U.S. for the ETI regime. The EU wants $4 billion a year in sanctions – the USTR's office believes we owe just under $1 billion. Either way, this is an untenable situation – both sound like big numbers to me.

We learned yesterday that the WTO arbitration panel has, for the third time this year, postponed its decision on the amount of sanctions the EU can levy. The arbitration panel has set a new decision date of mid-August. And so, this bring us to the issue we must face at this significant juncture: where do we go from here? And how long do we have to comply? Sanctions would be very harmful to our recovering economy and to our trade relationship with Europe.

On the other hand, an outright repeal of ETI could have a devastating effect on large segments of U.S. business and their job base. One business group has estimated that as many as 3.5 million U.S. jobs are attributable to the export benefits of FSC, which the current ETI replaced.

And let us be clear. ETI, for better or worse, does enhance our ability to manufacture at home and sell abroad. The President has told the EU that we will comply with our WTO obligations. And I think the President is right. We must honor our WTO obligations. But what does compliance mean? This raises many questions. Does it require the full repeal of ETI? Or does it also involve a negotiated settlement with the EU?

Another important question is how long we have to resolve a compliance solution. We gave the EU several years to comply with the bananas decision before taking action. Will the same consideration be given to the U.S. before the EU imposes sanctions? We are receiving mixed messages on the timing of sanctions. Last spring, the EU signaled it would not impose sanctions while Congress is working on this issue. EC staff spoke openly that they did not want a trade war with the U.S.

Yesterday, however, I read in the paper that the Danish EU President wants a "speedy" repeal of the ETI regime. The Danish Ambassador stated that a recent Ways and Means proposal to repeal ETI is a "significant marker on the road to U.S. compliance" and that Congress must "maintain momentum" toward repeal.

If compliance means repeal, what, if anything, should replace ETI? And how can we ensure that

those ETI-related jobs remain in the U.S.? These are all very difficult questions that must be explored and answered by this committee. I would like to suggest that to accomplish this goal, we start with a clean slate and set up a fair process for moving this issue forward. First, we need to define the specific competitive disadvantages that our tax system creates. This issue has been reviewed in a piecemeal fashion for many years. But I think we need to review the specific issues that FSC and ETI were designed to address, and bring our understanding of those issues up to date.
Next, I would like to see us engage in a legislative process similar to that used in the successful passage of the ETI regime.

We created a bicameral, bipartisan working group that included the staff of this committee, the Ways and Means Committee, Treasury, and USTR. This working group received input from all concerned parties, including the business and legal community, labor, and anyone else wishing to have a say in the resolution of the FSC case. I think we need to put a similar process in place, and this effort needs to be lead by USTR and Treasury. Only USTR and Treasury have the resources and expertise to ensure the success of this process. I would even invite the EU to participate as a commentator so we can seek a mutual resolution of this issue.

The objective of this working group should be bipartisan legislation that can swiftly pass both houses. The legislative process on ETI has already begun. To its credit, the Ways and Means Committee has held numerous hearings on this issue, and its chairman has laid down a proposal for consideration and discussion. We should build on those efforts to produce a comprehensive solution to ensure timely compliance with our WTO obligations. At this stage, I doubt that any of us know what final compliance will look like. I think we can all agree, however, that we should not create another regime that violates our international trade agreements.

The present dispute over how to tax the foreign earnings of certain United States corporations is not new. We have been wrestling with this question in one form or another at least since the late 1960s. During the course of the current WTO litigation, these issues have been extensively debated, and I do not intend to address the relative merits of these arguments here. The WTO panel, and later the Appellate Body, listened to our arguments, and we lost. But there is one overall point that I want to make with respect to this dispute.

It is that we are still confronted with a decades-old distinction in global trade rules between direct taxes on income and indirect taxes on products. WTO rules allow the refund of indirect taxes for goods and products that are exported. But these same rules do not provide any relief for direct taxes on income from products or goods that are exported. The United States is the only major economic power that I know of that doesn't have a broad-based national indirect tax like a VAT. So under current WTO rules, United States exporters are at a significant competitive disadvantage.

In the TPA bill, Congress has directed USTR to address the fact that under the current WTO rules, rebates of indirect taxes, such as VAT taxes, cannot be considered illegal export subsidies. On the other hand, lower direct taxes, such as income taxes, may be illegal export subsidies. How can we justify allowing this distinction to continue? It discriminates against our system which is based on income taxation. That said, I believe it is crucially important that the United States abide by the rule of law.

When the Foreign Sales Corporation repeal legislation was considered by this committee on September 19, 2000, I stated then that in my view it was terribly important that we must promote the rule of law internationally. It was in that spirit that I offered my amendment to remove the Dividend Received Deduction, which the WTO specifically identified as offending WTO rules, from the FSC repeal legislation. As I recall, my amendment was the only one that was accepted. Unfortunately, my amendment wasn't enough to bring our legislation into compliance with WTO rules.

But I believe the principle I fought for is just as valid now as it was then. As one of the founding members of the GATT, and now the WTO, what we do is much more important than what we say. Other countries look to us to lead, and to set an example. If we don't comply fully with WTO rules, we only weaken the WTO. A weak and ineffectual WTO helps no one, and hurts us all. A weak WTO will allow protectionism to gain a stronger foothold around the world. We must not let that happen.